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C O N F I D E N T I A L SECTION 01 OF 02 VILNIUS 000766

SIPDIS

DEPT FOR EEB/IFD/OMA:ASNOW
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E.O. 12958: DECL: 09/16/2018

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SUBJECT: LITHUANIAN FINANCE MINISTER SAYS ECONOMY IS
"DEVELOPING" BUT CHALLENGES LOOM

REF: 2007 VILNIUS 620

Classified By: AMBASSADOR CLOUD FOR REASONS 1.4 (B) AND (D)

¶1. (C) Summary. On August 28, Lithuanian Finance Minister Rimantas Sadzius told the Ambassador that Lithuania's economy is not weakening, but developing, albeit at a slower pace than in the recent past. Inflation will be higher this year than last, but has stabilized according to Sadzius. Higher Eurozone inflation may help Lithuania's entry into the common currency but Sadzius does not expect Lithuania to cross this threshold by 2010. End summary.

Go GDP!

¶2. (C) Sadzius insisted that Lithuania's economy is not weakening but developing. Sadzius said he expected a 5.5 percent GDP growth rate for 2008, which he described as impressive. For 2009, Sadzius expected a growth rate of around four percent.

Inflating Into The Euro

¶3. (C) Inflation has stabilized by itself according to Sadzius. He said the GOL has little influence on this economic factor, presumably referring to the lack of monetary policy in Lithuania due to the Litas being pegged to the Euro. Sadzius added that food prices in Lithuania were finally beginning to stabilize at seven to nine percent growth, similar to the rest of the EU. He also said that gasoline and oil prices remain high. He acknowledged that Lithuania had experienced growth of 18 to 20 percent in food prices in the recent past but added that Lithuania's food prices were still only 75 percent of the EU average. Sadzius predicted that the cost of services as well as public transport would increase.

¶4. (C) Sadzius said that EU-wide inflation might benefit Lithuania's entry into the Eurozone, as the Maastricht criteria now include four percent inflation and likely to go higher next year; when Lithuania's Euro bid was last rejected, the allowable inflation rate was 2.6 percent. Sadzius said, however, that although entry into the Eurozone was of crucial importance for the Lithuanian economy it was unrealistic to expect it would happen by 2010.

¶5. (C) Sadzius had difficulty explaining the source of a recent resolution in the Lithuanian parliament to remove the Litas peg to the Euro, which he and most GOL officials who

have economic policy in their portfolio are against. Sadzius described the resolution as the first official doubt expressed about the currency board. Yet, he noted that the resolution only received 26 votes in parliament and was not signed by the Speaker. Sadzius added that export industries in Lithuania are not pushing for the de-linking of the Litas from the Euro.

Getting Growth Going

¶16. (C) Sadzius acknowledged that stifling bureaucracy makes it difficult for many businesses in Lithuania to pay their taxes. He said that making taxes easier to pay will make Lithuania more competitive in the EU. He also mentioned an existing R&D tax exemption for companies and how this could attract greater FDI.

Comment

¶17. (C) In the short term, there is little the GOL can do to encourage a return to the heady 8.8 percent GDP growth of ¶2007. The recent passage of a law indexing social benefits, including pensions, to inflation is likely to increase fiscal pressures on the GOL. The Fiscal Responsibility Law, a.k.a. the Balanced Budget Law, which took effect in 2008, may constrain future GOL expenditures but we have heard from some economic experts that this legislation could intensify economic peaks and troughs and was passed more for public

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image than a true desire to reform spending. Other economic concerns include a consumer confidence drop to its lowest level since the end of 2001, a slowdown in the real estate market, a jump in heating prices and an expected rise in electricity prices with the shutdown of the remaining Ignalina reactor on December 31, 2009. Nonetheless, Lithuania's situation may yet be better than its Baltic neighbors; according to Sadzius, Lithuania is neither in nor likely to enter a recession.
CLOUD